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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

ROBERT G. HOLMES, JR.,

Petitioner,

—vs.—

SECURITIES INVESTOR PROTECTION CORPORATION, *et al.*,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

This *Amicus Curiae* brief addresses the sole question upon which this Court granted the petition for writ of certiorari, *to wit*:

> Whether a party which was neither a purchaser nor a seller of securities, and for that reason lacked standing to sue under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, is free of that limitation on standing when presenting essentially the same claims under the Racketeer Influenced and Corrupt Organizations Act ("RICO").

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BRIEF OF AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

PRELIMINARY STATEMENT

The American Institute of Certified Public Accountants (the "Institute") respectfully submits this brief as *amicus curiae* pursuant to Rule 37.3 of the Rules of this Court in support of petitioner, Robert G. Holmes, Jr., and urges that this Court reverse the judgment of the United States Court of Appeals for the Ninth Circuit, entered in these proceedings on August 3, 1990 and reported at 908 F.2d 1461 (9th Cir. 1990), insofar as it reversed the Order of the United States

District Court for the Central District of California. This brief is submitted on consent of the parties, and their written consents are being filed with the Clerk of the Court contemporaneously herewith.

INTEREST OF THE INSTITUTE AS *AMICUS CURIAE*

The Institute is the national professional accounting organization, all of whose more than 300,000 members are certified public accountants. Among the Institute's purposes are the promotion and maintenance of high professional standards of practice. In the pursuit of those ends, the Institute has come to be accepted as the authoritative source of standards and procedures in its field.

As the issuer of these standards, the Institute has a profound interest in the scope and bases of civil liability sought to be imposed on auditors in connection with their performance of professional engagements under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961-1968 ("RICO"), Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982) ("Section 10(b)" and the "1934 Act") and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (1986) ("Rule 10b-5") promulgated thereunder. The Institute's substantial and legitimate interest in this body of law has long been recognized both by this Court and the Congress.[1]

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1 The Institute was invited to and did submit a position paper to the United States Senate addressing the proposed scope of civil liabilities and damages under the 1934 Act. *Hearings on S. Res. 84 (72d Cong.), S. Res. 56, and S. Res. 97 Before the Comm. on Banking and Currency*, 73d Cong., 1st Sess., pt. 15, at 7207-10 (1934). Furthermore, this Court has permitted the Institute to file briefs *amici curiae* on related securities laws issues in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, *reh'g denied*, 425 U.S. 986 (1976); *Touche Ross & Co. v. Redington*, 442 U.S. 560 (1979); *Aaron v. SEC*, 446 U.S. 680 (1980); *Ross v. A. H. Robins Co.*, 607 F.2d 545 (2d Cir. 1979), *cert. denied*, *(footnote continued)*

Although this case does not involve a claim against a member of the accounting profession, the potential impact of the Ninth Circuit's ruling on accountants is severe. Accountants play an integral role in the dissemination of financial information pursuant to the federal securities laws. When auditors express opinions on financial statements, they become exposed to suits brought by investors, creditors and others who may claim to have relied upon those statements in making investment decisions or entering into business transactions with auditors' clients. Upon the financial collapse of corporations, outside professionals, such as accountants, like other surviving solvent parties, are "targets of opportunity" in private RICO actions for treble damages. Dramatic expansions of civil liability under RICO, as exemplified by the decision below, foster "a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 739, *reh'g denied*, 423 U.S. 884 (1975).

The Ninth Circuit held that the rule of *Blue Chip Stamps* and *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952), limiting private civil actions for damages under Section 10(b) and Rule 10b-5 to plaintiffs who are actual purchasers or sellers of securities, is inapplicable in civil RICO actions predicated on "fraud in the sale of securities." 18 U.S.C. § 1961(1)(D). In reaching this anomalous result, the Court below disregarded the language and structure of RICO and swept aside a half-century of federal securities law. Under the decision of the Court below, a civil plaintiff may assert a securities fraud claim as a violation of RICO, even though the same plaintiff would have been barred from asserting the same claim under the federal securities laws. This opens the floodgates to a new breed of abusive RICO litigation that will plague legitimate

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(continued footnote)

446 U.S. 946 (1980); and *Basic Inc. v. Levinson*, 485 U.S. 224 (1988). On the subject of RICO, the Institute participated as *amicus curiae* in *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479 (1985), and *H.J. Inc. v. Northwestern Bell Tel. Co.*, 492 U.S. 229 (1989).

businesses and their certified public accountants as well as the federal courts.

Members of the Institute, therefore, along with other professionals, have a vital interest in urging this Court to adopt an interpretation of RICO that not only will dispose of the case before the Court, but will do so in a manner that brings consistency, predictability and coherence to the interpretation of RICO and the antifraud provisions of the federal securities laws.

STATEMENT OF THE CASE

Petitioner, Robert G. Holmes, Jr., is the founder, chief executive officer, president, and a major stockholder of Aero Systems, Inc. ("Aero"). Mr. Holmes also was a shareholder in Bunnington Corp. ("Bunnington"). Respondent, the Securities Investor Protection Corporation ("SIPC"), is a nonprofit membership corporation consisting of most registered securities brokers and dealers.

In July, 1981, the SIPC instituted liquidation proceedings against two brokerage houses: First State Securities Corp. ("FSSC") and Joseph Sebag, Inc. ("Sebag"). Acting as liquidator of the brokerage houses, the SIPC alleged that it had to disburse nearly $13 million to meet customers' claims for which the brokerages' assets were insufficient.

In July, 1983, the SIPC, together with the trustees appointed for the liquidation of the failed brokerages, commenced litigation in the United States District Court for the Central District of California against seventy-five defendants, alleging securities fraud in violation of Section 10(b) of the 1934 Act and Rule 10b-5 thereunder, a conspiracy under RICO, common law fraud, and breach of fiduciary duty. It was alleged that from 1964 through July 1981, the defendants engaged in a scheme to manipulate the stock of six companies, including Aero and Bunnington, traded in the over-the-counter market, and that defendants used FSSC and Sebag to further the scheme.

Petitioner moved for summary judgment in the District Court on the ground, *inter alia*, that SIPC had no standing to maintain claims against him under Section 10(b) and Rule 10b-5, or under RICO, because SIPC was not a purchaser or seller of securities. Petitioner also argued that plaintiffs lacked standing under RICO because their alleged injuries were not caused by reason of the alleged RICO violation. The SIPC was not a purchaser or seller of any securities and failed to show, in the District Court, that it was subrogated to the claims of any of FSSC's or Sebag's customers who had unauthorized transactions in their accounts and who were themselves purchasers or sellers of securities. *See* Petition for Writ of Certiorari of Robert G. Holmes, Jr., at 6.

The District Court granted petitioner's motion for summary judgment, holding, *inter alia*, that: (1) SIPC was not a purchaser or seller of securities and it therefore lacked standing to assert RICO claims predicated upon a violation of Section 10(b) and Rule 10b-5; and (2) the injuries alleged by plaintiffs were not causally connected to petitioner's conduct, and thus, petitioner was entitled to summary judgment on the claims under RICO and the federal securities laws.

The Ninth Circuit reversed the judgment of the District Court, and held that SIPC did not have to be a purchaser or seller of securities to assert a RICO claim predicated upon alleged Section 10(b) and Rule 10b-5 violations. The Court reasoned that the language of RICO granting a private right of action, 18 U.S.C. § 1964(c), did not impose a purchaser/seller requirement upon private plaintiffs; however, the Court failed to address the specific language of 18 U.S.C. § 1961(1)(D), upon which SIPC relied, which requires a showing of "fraud in the *sale* of securities" (emphasis added). The Ninth Circuit concluded that this Court's decision in *Blue Chip Stamps* need not be followed in a RICO case alleging securities fraud because the purchaser/seller requirement announced in *Blue Chip Stamps* arose in the context of a private right of action for securities fraud that was "court created." *SIPC v. Vigman*, 908 F.2d 1461, 1466

(9th Cir. 1990), *cert. granted in part sub nom. Holmes v. SIPC*, 111 S. Ct. 1618 (1991).

SUMMARY OF ARGUMENT

Delineating the proper contours of a private right of action under RICO, predicated on a claim of "fraud in the sale of securities," requires an exacting analysis of the statute, its structure, and its relationship with the existing federal securities laws. The Court below eschewed this approach. Instead, it declared that strangers to a securities transaction could have standing under RICO to assert securities fraud claims, upon the mere allegation that they were somehow injured by a fraud. This result circumvents a half-century of carefully-crafted federal securities law, particularly the rule of *Blue Chip Stamps* restricting the plaintiff class asserting Section 10(b) claims to actual purchasers and sellers of securities, and invites those with untenable federal securities fraud claims to assert the very same claims, in federal court, under the guise of RICO. The decision below offers an added unwarranted and unwise litigation incentive; the repackaged securities claim is rewarded with the promise of treble damages and attorneys' fees, none of which would be available even if the securities fraud claim were cognizable. RICO was not intended to give life to defective federal securities law claims much less to endow them with windfall recovery potential; however, that is precisely what the Court below has achieved.

The rationale and decision of the Court below are flawed as a matter of law and policy, and should be rejected. In finding that RICO did not impose a purchaser/seller requirement upon private RICO plaintiffs, the Court below focused exclusively upon the broad language of RICO's private right of action. 18 U.S.C. § 1964(c). The Court failed to recognize, however, that no private right of action accrues until, *inter alia*, plaintiff can demonstrate the existence of "racketeering activity," namely, "fraud in the *sale* of securities." 18 U.S.C. § 1961(1)(D) (emphasis added). The language of the predicate act itself and its appropriate structural relationship

to the 1934 Act separately and together compel the conclusion that a private action for treble damages under RICO should be limited to those who were defrauded in the actual sale of securities.

The same result is dictated, for similar reasons of statutory construction, by the requirement of RICO that SIPC establish that its alleged injury was caused *by reason of* the RICO violation. 18 U.S.C. § 1964(c). SIPC was neither a purchaser nor seller of securities, and its injury was not proximately caused by the RICO violation. *Blue Chip Stamps* embodies the sound policy decision that bystanders to the securities marketing process should not be accorded a private right of action under Section 10(b). The injuries alleged by SIPC—a stranger to any sales transaction and the target of no racketeering activity—should not be cognizable under RICO.

The decision below has grave ramifications for legitimate businesses, including accounting firms, and the securities markets. By exempting RICO plaintiffs from the purchaser/seller requirement, the decision below will contribute to the continuing growth of RICO actions against accountants. The exposure to risk of treble damages, potentially irreparable harm to professional reputation, and time-consuming and costly litigation, all tend to promote extortive settlements. This consequence imposes considerable societal costs. The unwarranted expansion of accountants' liability may impede or prevent the critical flow of financial information as accounting services become either more costly or unavailable, and thereby harm investors, the capital markets, and competition. By subjecting accountants and others to potentially limitless liability in actions initiated by strangers to securities transactions, the Court below has announced a result that is unsupportable as a matter of law or public policy. The decision of the Ninth Circuit should be reversed.

ARGUMENT

POINT I

THE DECISION BELOW DISREGARDED THE PLAIN LANGUAGE AND STRUCTURE OF RICO.

Congress has provided that "[t]he provisions of [RICO] shall be liberally construed to effectuate its remedial purposes," Organized Crime Control Act of 1970, Pub. L. No. 91-452, § 904(a), 84 Stat. 922, 947, and this Court has noted that "RICO is to be read broadly." *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 497 (1985). These admonitions, however, cannot override the primacy of the statutory language of RICO. *See Touche Ross & Co. v. Redington*, 442 U.S. 560, 578 (1979). In the RICO context, this Court has held: "we look first to its language. If the statutory language is unambiguous, in the absence of 'a clearly expressed legislative intent to the contrary, that language must ordinarily be regarded as conclusive.' " *United States v. Turkette*, 452 U.S. 576, 580 (1981) (citation omitted); *Russello v. United States*, 464 U.S. 16, 20 (1983); *see also Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 201, *reh'g denied*, 425 U.S. 986 (1976) (in construing Section 10(b), a remedial statute, this Court held that "[t]he language of a statute controls when sufficiently clear in its context"); *accord Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 477 (1977). In construing RICO, the intention of Congress is "best determined by the statutory language that it chooses." *Sedima*, 473 U.S. at 495 n.13.

This Court should not construe RICO in a manner that would supersede and eclipse 50 years of reasoned adjudication of the federal securities laws. The provisions of RICO, particularly sections 1961(1)(D), 1962, and 1964(c), should be construed to harmonize, and function in coordination, with the federal securities laws. *See SEC v. National Sec., Inc.*, 393 U.S. 453, 466 (1969) ("the inter-dependence of the various sections of the securities laws is certainly a relevant factor in any interpretation of the language Congress has chosen"); *Randall v. Loftsgaarden*, 478 U.S. 647, 661 (1986).

A. A RICO Action, Predicated On Allegations Of Securities Fraud, Is Properly Confined To Private Plaintiffs Who Were Parties To The Sale Transaction.

Section 1964(c) of RICO authorizes a private suit by "[a]ny person injured in his business or property by reason of a violation of § 1962." 18 U.S.C. § 1964(c). As held by this Court, "[i]f the defendant engages in a pattern of racketeering activity in a manner forbidden by [Section 1962], and the racketeering activities injure the plaintiff in his business or property, the plaintiff has a claim under § 1964(c)." *Sedima*, 473 U.S. at 495. The individual sections of RICO are interrelated and integrated within a single statute, and under the principle of *in pari materia*, should be construed together. *See Sullivan v. Everhart*, 110 S. Ct. 960, 966 (1990) (to be reported at 494 U.S. 83); *Erlenbaugh v. United States*, 409 U.S. 239, 244 (1972).

Section 1961(1)(D)—relied upon by SIPC to establish a RICO violation—defines racketeering activity as, *inter alia*, "any offense involving . . . fraud in the sale of securities . . . punishable under any law of the United States." This language is sufficiently clear in its context[2] and should be

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2 The term "racketeering activity" is defined in 18 U.S.C. § 1961, by a list containing specific State and Federal crimes characteristically committed by members of organized crime. McClellan, *The Organized Crime Act (S. 30) Or Its Critics: Which Threatens Civil Liberties?*, 46 NOTRE DAME LAW. 55, 142 (1970). The list of predicate acts was modeled on the listing of crimes for which Congress authorized electronic surveillance. *Id.* at 144. In designating specific predicate acts in Section 1961, Congress intended to bring existing crimes within RICO's reach, not to modify such crimes or create new ones. *Id.*

By denominating "fraud in the sale of securities" as a form of racketeering activity, Congress did not intend to create a "federal common law of fraud." *Bayly Corp. v. Marantette*, [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,834, at 94,291 (D.D.C. Oct. 19, 1982). In other words, RICO "does not make criminal conduct that before its enactment was not already prohibited, since its application depends on the existence of 'racketeering activity' that violates an independent criminal statute." Blakey & Gettings, *Racketeer Influenced and Corrupt Organizations (RICO): Basic Concepts—Criminal and Civil Rem-*

(footnote continued)

applied as written. Resort to legislative history is neither necessary nor helpful.[3]

Section 1961(1)(D) imposes liability only for fraud in the *sale* of securities, and thus, by its unambiguous terms, confers standing only upon those defrauded in the manner proscribed, the actual purchasers and sellers of securities who are parties to the "sale". *See International Data Bank, Ltd. v. Zepkin*, 812 F.2d 149, 152 (4th Cir. 1987) (hereinafter "*Zepkin*") (standing denied where plaintiff was not a purchaser or seller of securities); *see also First Pacific Bancorp, Inc. v. Bro*, 847 F.2d 542 (9th Cir. 1988) (violations of Sections 13(d) and 14(e) of the 1934 Act cannot be RICO securities fraud predicate acts because neither provision embraces fraud in the sale of a security).

(continued footnote)

edies, 53 TEMP. L.Q. 1009, 1021 n.71 (1980). Thus, by its structure and language, Section 1961(1)(D) defines racketeering activity as including "fraud in the sale of securities," but only to the extent such offense is punishable under existing federal criminal law.

3 Even if considered, the legislative history of RICO sheds little light upon the rationale of Congress in designating "fraud in the sale of securities" as one form of racketeering activity. One respected commentator has observed:

> How the . . . phrase got into the definition [of racketeering activity]—whose fourth category couples it with bankruptcy fraud and offenses involving dangerous drugs—is no more clear than what "fraud" means in this context. The closest reference in the legislative history is (in the testimony of J. Edgar Hoover) to "thefts of securities from brokerage houses," in a number of which "close associates and relatives of La Cosa Nostra figures are known to be involved."

L. Loss, FUNDAMENTALS OF SECURITIES REGULATION 711 (1988) (footnote omitted). The Congressional Statement of Findings and Purpose accompanying RICO states that: "organized crime activities in the United States weaken the stability of the Nation's economic system, *harm innocent investors* and competing organizations, interfere with free competition, seriously burden interstate and foreign commerce, threaten the domestic security, and undermine the general welfare of the Nation and its citizens." 84 Stat. 922, 923 (emphasis added).

The well reasoned decision of the Court of Appeals for the Fourth Circuit in *Zepkin*, 812 F.2d at 152, supports this conclusion. There the Court held: "[t]he statutory language describing the predicate offense—'fraud in the sale of securities'—is . . . narrow and suggests the pivotal role of the actual sales transaction." *Id.* Without deciding whether the term "fraud in the sale of securities" in 18 U.S.C. § 1961(1)(D) limits, by its own terms, RICO standing to actual parties to the sale, or merely incorporates the standing requirements of federal securities law to the same effect, the Fourth Circuit held that where the RICO plaintiff pleads a Rule 10b-5 predicate offense, standing is limited to the actual purchaser or seller of securities. *Id.* (citing MacIntosh, *Racketeer Influenced and Corrupt Organizations Act: Powerful New Tool of The Defrauded Securities Plaintiff*, 31 KAN. L. REV. 7, 37 (1982)).[4]

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4 Most of the lower courts that have considered the question have adopted this view and, similarly relying on the language of RICO itself and its coordination with the 1934 Act, have rejected civil RICO claims, predicated on Section 10(b) and Rule 10b-5, where the private plaintiff was not a purchaser or seller of securities. *Brannan v. Eisenstein*, 804 F.2d 1041, 1046 (8th Cir. 1986); *Viacom Int'l Inc. v. Icahn*, 747 F. Supp. 205, 210 (S.D.N.Y. 1990); *Kravetz v. Brukenfeld*, 591 F. Supp. 1383, 1388, 1390 (S.D.N.Y. 1984); *Chief Consol. Mining Co. v. Sunshine Mining Co.*, 725 F. Supp. 1191, 1194 (D. Utah 1989); *see also First Pacific Bancorp., Inc. v. Bro*, 847 F.2d 542, 546-47 (9th Cir. 1988) (relying upon *Zepkin*, the Court held that the statutory language of 18 U.S.C. § 1961(1)(D) required "evidence of a sale"); *Reliance Ins. Co. v. Eisner & Lubin*, 685 F. Supp. 449, 456-57 (D.N.J. 1988) (where plaintiff was not a purchaser or seller for purposes of 10b-5 claim, the claim was not considered for RICO purposes), *aff'd*, 897 F.2d 523 (3d Cir. 1990) (*see* 897 F.2d 521); *Moss v. Morgan Stanley Inc.*, 719 F.2d 5, 17-18 (2d Cir. 1983), *cert. denied*, 465 U.S. 1025 (1984) (plaintiff's lack of Rule 10b-5 standing precluded a civil RICO claim by plaintiff on the same alleged securities violations); *In re Par Pharmaceutical, Inc. Sec. Litig.*, 733 F. Supp. 668, 683-84 (S.D.N.Y. 1990) ("securities fraud is only a predicate offense if the fraud occurs in the actual *sale* of a security"). *But see Warner v. Alexander Grant & Co.*, 828 F.2d 1528, 1530 (11th Cir. 1987). The weight of persuasive authority supports the view of the Fourth Circuit. *See, e.g.*, Mathews, *Shifting the Burden of Losses In the Securities Markets: The Role*

(footnote continued)

This Court's analysis of the language of Section 10(b) in *Blue Chip Stamps*, and conclusion that it contains a purchaser/seller standing requirement, calls for a similar construction of Section 1961(1)(D) to restrict the potential class of RICO plaintiffs to actual parties to the sales transaction. In *Blue Chip Stamps*, this Court held that the language of Section 10(b) of the 1934 Act, proscribing fraud "in connection with the *purchase or sale*" of securities, was properly interpreted to reach only those injuries suffered by defrauded purchasers or sellers of securities. *Blue Chip Stamps*, 421 U.S. at 731, 733 (citing with approval *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952)). Section 1961(1)(D), proscribing "fraud in the *sale* of securities," should be construed to protect only those parties defrauded in the actual sales transaction. *See Zepkin*, 812 F.2d at 152; *accord Pinter v. Dahl*, 486 U.S. 622, 642 (1988) (the language of Section 12(1) of the 1933 Act, imposing liability upon any person who "offers or sells a security" to a purchaser, "contemplates a buyer-seller relationship not unlike contractual privity.")[5]

Such a restriction on standing under RICO is fully consistent with the will of Congress, as embodied in other provi-

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(continued footnote)

of Civil RICO in Securities Litigation, 65 NOTRE DAME L. REV. 896, 947 n.288 (1990) (hereinafter "*RICO in Securities Litigation*").

5 One commentator has noted: "If the statutory interpretation argument in *Blue Chip* is then applied, standing under section 1961(1)(D) would be restricted to buyers of securities alone." MacIntosh, *RICO: Powerful New Tool*, 31 KAN. L. REV. at 35 (footnote omitted). The weight of authority, however, suggests that 18 U.S.C. § 1961(1)(D) also reaches fraud in the purchase of securities. *See* L. Loss, FUNDAMENTALS OF SECURITIES REGULATION 711 n.43 (1988) (citing *Lickhalter v. System Dev. Corp.*, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,459 (C.D. Cal. Mar. 20, 1984)); *see also* Note, *Application of the Racketeer Influenced and Corrupt Organizations Act (RICO) to Securities Violations*, 8 J. CORP. L. 411, 430-31 (1983); J. Rakoff & H. Goldstein, *RICO: Civil and Criminal Law and Strategy* § 2.02[2] (1990); Mathews, *RICO in Securities Litigation*, 65 NOTRE DAME L. REV. at 945 n.273 (collecting cases).

sions of the 1933 Act and 1934 Act which confer express rights of action. By extending standing to non-purchasers and non-sellers, the Court below has improperly expanded the plaintiff class under RICO even beyond the bounds Congress delineated for comparable *express* rights of action. *See Blue Chip Stamps*, 421 U.S. at 736; Mathews, *RICO in Securities Litigation*, 65 NOTRE DAME L. REV. 896, 902-26 (1990). In reaching its conclusion, the Court below failed to give effect to *Blue Chip Stamps* on the ground that the purchaser/seller requirement was established by the Court in the context of construing an implied cause of action under Section 10(b) and Rule 10b-5. The decision below misapprehends the genesis of the rule of *Blue Chip Stamps*.

The outcome of *Blue Chip Stamps* was not contingent upon the implied nature of the right of action construed, but rather, the limitations inherent in the language of the provisions before the Court. *Blue Chip Stamps*, 421 U.S. at 731, 737; 421 U.S. at 755 (Powell, J., concurring); *see Birnbaum v. Newport Steel Corp.*, 193 F.2d 461, 463-464 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952); *Ernst & Ernst v. Hochfelder*, 425 U.S. at 200-01 ("Where, as here, we deal with a judicially implied liability, the statutory language certainly is no less important."). The Court's emphasis on statutory language in *Blue Chip Stamps* is well noted. Ruder, *Judicial Developments Under Rule 10b-5: Standing, Scienter, Reliance, Materiality and Implied Rights of Action*, 7TH ANN. INST. ON SEC. REG. 303, 313-14 (P.L.I. 1976). In concluding that *Blue Chip Stamps* was entitled to something less than deference in the RICO context, the Court below simply failed to acknowledge the *ratio decidendi* of *Blue Chip Stamps*, or apply the "plain language" of Section 1961(1)(D) as written. *See Sedima*, 473 U.S. at 495 n.13. Had the Ninth Circuit employed the proper statutory analysis, the conclusion would have been inescapable that a purchaser/seller standing requirement exists under 18 U.S.C. § 1961(1)(D).

In reaching the opposite result, the decision below effectively repeals by implication a half-century of jurisprudence which has invested the federal securities law with clear mean-

ing. *Zepkin* 812 F.2d at 152-53. In applying those statutes, this Court has held: " '[i]t is, of course, a cardinal principle of statutory construction that repeals by implication are not favored.' " *Randall v. Loftsgaarden*, 478 U.S. 647, 661 (1986) (citation omitted). This principle has particular force where, as here, a general statute operates to repeal a more specific one. *United States v. United Continental Tuna Corp.*, 425 U.S. 164, 168 (1976). By permitting a plaintiff to evade the purchaser/seller requirement at will, the Court below has rendered long-settled restrictions in securities fraud cases ineffectual, and nullified the specific Congressional policies those restrictions implement.

To expand the plaintiff class in the manner allowed by the Court below, would allow civil RICO to disrupt or displace decades of statutory and judicial development of civil remedies under the federal securities laws. *Sedima*, 473 U.S. at 504, 505 (Marshall, J., dissenting). That development has recognized the importance of the integrated statutory scheme to its proper interpretation and enforcement. "The 1933 and 1934 Acts constitute interrelated components of the federal regulatory scheme governing transactions in securities." *Ernst & Ernst v. Hochfelder*, 425 U.S. at 206. This Court has often recognized the elaborate and careful calculus of these statutes in giving meaning to their provisions. *See, e.g., Ernst & Ernst v. Hochfelder*, 425 U.S. at 206 (citing *SEC v. National Sec., Inc.*, 393 U.S. 453, 466 (1969)); *Blue Chip Stamps*, 421 U.S. at 727-30; *Touche Ross & Co. v. Redington*, 442 U.S. 560, 571-73 (1979); *Aaron v. SEC*, 446 U.S. 680, 695 (1980). All this would be swept away if the interpretation below were to prevail, and the carefully articulated balance of policy concerns crafted by Congress would be destroyed.

As the Securities and Exchange Commission itself has recognized, this result is neither correct nor sound. It has expressed concern that the civil liability provisions of RICO operate in many cases to "convert otherwise untenable routine private securities fraud claims into RICO claims" thereby exposing defendants to extraordinary liability not available under the securities laws themselves. *See Statement*

of Mary L. Schapiro, Comm'r, SEC, Concerning RICO Amendments Act of 1991: Hearing on H.R. 1717 Before the Subcomm. on Intellectual Property and Judicial Administration of the House Judiciary Comm., quoted in 6 Civil RICO Report, at 1-2 (Apr. 30, 1991). Thus, the SEC has recognized that RICO, as applied by certain courts, has "undermine[d] the balanced structure that has developed under the federal securities laws" and such "distortion imposes substantial costs on corporate issuers and securities firms." *Id.*

Addressing a similar issue, Justice John Marshall Harlan provided this guidance as to how a general provision of securities law should interact with preexisting, specific federal securities laws:

> Courts and commentators have long debated whether Rule 10b-5 should be read as a sweeping prohibition against fraud in the securities industries when this results in rendering nullities of the other antifraud provisions of more limited scope which can be found in the statute books. The late Judge Jerome Frank, Professor Louis Loss and Milton Cohen,—to mention only three of those particularly eminent in this field—have warned that Rule 10b-5 should not be construed to supersede the special statutory schemes which Congress has devised to assure fair dealing in various aspects of the securities business.

SEC v. National Sec., Inc., 393 U.S. 453, 470 (1969) (Harlan, J., concurring) (citations & footnotes omitted); *see also* AICPA, *The Authority to Bring Private Treble-Damage Suits Under 'RICO' Should Be Reformed*, AICPA White Paper on Civil RICO, at 44-45 (Oct. 10, 1984), *quoted in Report of the Ad Hoc Civil RICO Task Force of the ABA Section of Corporation, Banking and Business Law* 24 (Mar. 28, 1985).[6]

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6 Additionally, it should be noted that Section 1961(1)(d) defines predicate acts that may be the subject of criminal, as well as civil adjudica-

(footnote continued)

B. SIPC Was Not Injured By Reason Of Fraud In The Sale Of Securities.

In deciding that the SIPC had standing to sue under RICO, the Court below commenced and concluded its analysis of the issue by referring solely to the broad language of 18 U.S.C. § 1964(c). A private right of action is provided under RICO to "[a]ny person injured in *his* business or property *by reason of* a violation of Section 1962." 18 U.S.C. § 1964(c). The phrase "by reason of" imposes a proximate cause requirement upon private plaintiffs. *Haroco, Inc. v. American Nat'l Bank & Trust Co.*, 747 F.2d 384, 398 (7th Cir. 1984), *aff'd*, 473 U.S. 606 (1985) (per curiam). " '[A] defendant who violates section 1962 [of RICO] is not liable for treble damages to everyone he might have injured by other conduct, nor is the defendant liable to those who have not been injured.' " *Sedima*, 473 U.S. at 496-97 (quoting *Haroco*, 747 F.2d at 398). Thus, any recoverable damages occurring by reason of a violation of Section 1962 "will flow from the commission of the predicate acts." *Id.*

In order to sustain its right of action under RICO, the SIPC was required to establish that its injury was caused by reason of the "fraud in the sale of securities." 18 U.S.C. §§ 1961(1)(D), 1964(c). The ambit of persons who can claim to have sustained judicially cognizable injury from such securities transaction has already been determined by this Court in *Blue Chip Stamps*, 421 U.S. at 733-736. The statutory and policy rationale of that case is equally applicable here, and the language of Section 1964(c) should be interpreted *in pari materia* with the nexus prescribed by Section 10(b). Consequently, whether viewed as a "bystander[ ] to the securities marketing process," *Blue Chip Stamps*, 421 U.S. at 747, or

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(continued footnote)

tion. The purchaser/seller requirement may be imposed in the context of a private action for damages, without necessarily imposing a similar requirement upon the government in a criminal prosecution of the same conduct under the same law. *See United States v. Naftalin*, 441 U.S. 768, 774 n.6 (1979).

as an indirectly injured party, *Zepkin*, 812 F.2d at 153, SIPC did not incur its injury by reason of a fraud in the sale of securities, and therefore lacks standing under RICO.

POINT II

THE DECISION BELOW IMPOSES POTENTIAL LIABILITY OF INDETERMINATE SCOPE TO AN INFINITE CLASS OF PLAINTIFFS IN DEROGATION OF SETTLED PUBLIC POLICY.

Over the last generation, there have been numerous attempts by plaintiffs to expand liability under the federal securities laws beyond their legislatively-defined scope. These efforts have been largely unsuccessful. *See, e.g., Blue Chip Stamps*, 421 U.S. 723; *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976) (scienter must be established in a private action for damages under Section 10(b) of the 1934 Act); *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977) (breaches of fiduciary duty in connection with corporate mergers are not actionable under Section 10(b) and Rule 10b-5).

These decisions reflect the basic policy considerations that civil liability should be defined by the words of the statute, read in their context, and must be confined within reasonably manageable bounds. *Blue Chip Stamps*, 421 U.S. at 739-49; *Ernst & Ernst v. Hochfelder*, 425 U.S. at 214 n.33; *Santa Fe*, 430 U.S. at 478-79. The Court below, however, not only disregarded the language of Sections 1961(1)(D) and 1964(c), but it also failed to appreciate the grave policy concerns raised by its expansive view of RICO liability. These public policy concerns, therefore, bear emphasis and reaffirmation.

The Harm of Vexatious Litigation

Litigation under civil RICO, as manifested by the decision below, embodies the very evils that RICO was designed to combat. RICO has been used for "extortive purposes." *Sedima*, 473 U.S. at 506 (1985) (Marshall, J., dissenting);

Report of the Ad Hoc Civil RICO Task Force of the ABA Section of Corporation, Banking and Business Law 69. The purchaser/seller requirement is designed, in part, to screen out "fraudulent suits." *Blue Chip Stamps* 421 U.S. at 761 n.5 (Powell, J., concurring). The decision below creates irresistable incentives for private plaintiffs, in their unfettered discretion, to use extortive and fraudulent litigation to exact lucrative settlements. In a very real sense, the cure has become the disease.

The dynamics of the "strike" suit underscore the point. One class action attorney, arguing for expansive liability, has stated: " 'Someone has to pay when a person . . . invests in a company that goes sour.' " Berton, *Investors Call CPAs To Account*, Wall St. J., Jan. 28, 1985, at 30, col. 4. Employing this mind set, RICO cases can be built against legitimate businesses, including accounting firms, "on a scaffolding of the merest guesswork and supposition, junk science, and prejudicial tidbits." W. Olsen, THE LITIGATION EXPLOSION 289 (1991). It is therefore not surprising, but regrettable, that in the year subsequent to *Sedima* alone, "at least 22 RICO suits [had] been filed against small CPA firms who have AICPA insurance and at least 31 against larger firms, according to AICPA general counsel Donald Schneeman." Galen, *Litigation Blitz Hits Accountants*, Nat'l L.J., Jun. 16, 1986, at 27, col. 1.

The scope of liability under the securities law established in *Blue Chip Stamps* embodies a policy judgment of Congress, given effect by this Court, that excessive exposure to damage claims does "more harm than good." *Blue Chip Stamps*, 421 U.S. at 748. That judgment is equally applicable here. In particular, then Justice (now Chief Justice) Rehnquist identified the significant policy reasons justifying the purchaser/seller rule in his opinion for the Court in *Blue Chip Stamps*.

First, "litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." *Blue Chip Stamps*, 421 U.S. at 739. Such litigation threatens an undue risk of abuse,

distortion of the securities market, large judgments ultimately payable by innocent investors, meritless "strike" suits with disproportionate settlement value, frustration or delay of normal business activity, extensive depositions and discovery of business documents, and the hazards of a liability in an indeterminate amount, for an indeterminate time, to an indeterminate class. *Id.* at 739-49 (citation omitted).

Second, the vexatious litigation that would arise would be marked by cases built upon oral testimony, uncorroborated by documentary or objective evidence, and not susceptible to pre-trial dismissal. An actual purchaser or seller would be capable of documenting and verifying the purchase or sale in most cases. In contrast, a person choosing *not* to purchase or sell securities would be dependent upon his or her own oral testimony—not an objectively demonstrable fact—which would need to be assessed by the jury. *Blue Chips Stamps*, 421 U.S. at 743-48. The potential for abuse and fraud, absent the purchaser/seller requirement, is manifest.

The same considerations that motivated this Court in *Blue Chip Stamps* to restrict the plaintiff class in securities fraud cases to purchasers and sellers should, *a fortiori*, compel the same result in this RICO action for treble damages and attorneys' fees.

Harm to the Accounting Profession

The continued, abusive expansion of RICO will harm the very entities the statute was designed to protect: legitimate businesses such as accounting firms. Since at least 1985, there has been virtual unanimity that "in its private civil version, RICO is evolving into something quite different from the original conception of its enactors." *Sedima*, 473 U.S. at 500; 473 U.S. at 500-01 (Marshall, J., dissenting); 473 U.S. at 524-25 (Powell, J., dissenting); *H.J. Inc. v. Northwestern Bell Tel. Co.*, 492 U.S. 229, 255 (1989) (Scalia, J., concurring). The Court below has accelerated this evolution. If allowed to stand, the decision below will cause an explosion

of vexatious suits against legitimate businesses, such as accounting firms, seeking treble damages and attorneys' fees, commenced by strangers to the challenged commercial and securities transactions, which have heretofore been barred.

The evolution of RICO alluded to in *Sedima* has degenerated to the level of the absurd. As one editorial recently noted:

> Along with couples suing each other as racketeers in divorces, among the 1,000 or so cases filed in the past year are companies suing each other as racketeers for claims they made in pet-food advertisements and a California lawyer who sued the City of Huntington Beach as a criminal enterprise for giving him three speeding tickets. Scores of such cases are lured by the promise of triple damages and the opportunity to slander the other side with "racketeer."

Look Who's Saving RICO, Wall St. J., May 24, 1991, at A10, col. 1. This trend dramatically affects accountants. Accountants, like other potential defendants, have a great interest in stemming this "inexorable broadening of the class of plaintiff[s]" in fraud actions:

> In *Ultramares Corp. v. Touche*, 255 N.Y. 170, 174 N.E. 441 (1931), Chief Judge Cardozo observed with respect to "a liability in an indeterminate amount for an indeterminate time to an indeterminate class":
>
> > "The hazards of a business conducted on these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exposes to these consequences." *Id.*, at 179-180, 174 N.E., at 444.

Blue Chip Stamps, 421 U.S. at 747-48. The wisdom of *Ultramares*, as reaffirmed in *Blue Chip Stamps*, was simply not adequately considered by the Court below.

The threat thus imposed involves more than economic harm. As professionals, accountants and accounting firms depend for their livelihood on fostering a reputation for careful, high-quality work. *See DiLeo v. Ernst & Young*, 901 F.2d 624, 629 (7th Cir.), *cert. denied*, 111 S. Ct. 347 (1990). The strike suits that would proliferate under the decision of the Court below can cause substantial harm to the reputation of an accounting firm, which is arguably its "most valuable economic asset." *O'Brien v. Price Waterhouse*, 740 F. Supp. 276, 280 (S.D.N.Y. 1990) (Leisure, J.). The purchaser/seller requirement enables the district court to evaluate claims against an objectively verifiable standard, and thereby protects the spectrum of defendants, including accountants, from reckless and unfounded public attacks upon their reputations. *Blue Chip Stamps*, *supra*. The decision below invites securities fraud claims, built upon uncorroborated oral assertions that may be advanced by the world at large, that may not be susceptible to dismissal before trial. *Blue Chip Stamps*, *supra*. This accords RICO claims enhanced *in terrorem* effect, inasmuch as it is often easier to settle a frivolous case than repair the damage inflicted when publicly branded a "racketeer."

The added threat of potentially indeterminate liability could in fact have the undesirable effect of limiting the availability of high-quality accounting services. In order to avert the possibility of crippling liability, many accountants would consider simply declining audits of enterprises they perceive as risks—the very enterprises as to whom the public could most benefit from a high-quality audit. *See generally* Minow, *Accountants' Liability and the Litigation Explosion*, J. Acct., Sept. 1984, at 70, 80; Siliciano, *Negligent Accounting and the Limits of Instrumental Tort Reform*, 86 MICH. L. REV. 1929, 1960-63 (1988). Larger firms may not wish to risk the damage to their reputations that could result from a deluge of RICO actions even if those suits were meritless, while smaller firms may often find that the expense of defending themselves against such a deluge could drive them out of business.

The unwarranted expansion of accountants' liability under RICO would chill the free flow of information in commercial relationships in additional ways. As recognized by the United States Court of Appeals for the Seventh Circuit, the improper extension of accountants' liability would increase the costs of accountancy services, and thereby diminish the accessibility to such services. *DiLeo v. Ernst & Young*, 901 F.2d 624, 629 (7th Cir.), *cert. denied*, 111 S. Ct. 347 (1990). Accountants play an integral role in the dissemination of financial information, a process at the core of the federal securities laws. *See* 1933 Act, 15 U.S.C. § 77aa (Schedule A) (25)-(27); and, 1934 Act, 15 U.S.C. § 78*l*(b)(1)(J)-(K). The decision below will only increase the initiation of litigation against accountants, with concomitant costs to the accounting profession, the investing public, and society.

The Disruption of the Capital Markets

This chilling effect upon the delivery of accountancy services also operates to impair the proper functioning of the capital markets. The capital markets, through which securities are traded and resources are allocated, function on the principle of "informational market efficiency." Jagannathan & Palfry, *Effects of Insider Trading Disclosures on Speculative Activity and Future Prices*, 27 ECON. INQUIRY 411, 427 (1989); *see Basic Inc. v. Levinson*, 485 U.S. 224, 245-47 (1988). In an efficient capital market, firms can make production and investment decisions, and investors can choose among securities that represent ownership of issuing firms, under the assumption that security prices at any time fully reflect all available information. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383 (May 1970). This has long been recognized. Douglas & Bates, *The Federal Securities Act of 1933*, 43 YALE L.J. 171, 172 (1933). A rule of law that has as its inexorable consequence the diminution of information available to businesses and investors, and the disruption of the equilibrium of capital markets, embodies bad public policy.

Harms to Business and Competition

Blue Chip Stamps understood that "[t]he very pendency of the [securities fraud] lawsuit may frustrate or delay normal business activity of the defendant which is totally unrelated to the lawsuit." *Blue Chip Stamps*, 421 U.S. at 740 (citations omitted). This is also true in the context of RICO. The SEC has argued that the potential liabilities associated with civil RICO "impede capital formation" by issuers and may "discourage innovation by financial service providers," and thus, "put[ ] the United States at a competitive disadvantage by discouraging foreign involvement in our markets." 6 Civil RICO Report, *supra*, at 2. From a business perspective, the costs of RICO, as typified by decisions such as that of the Court below, are unquantifiable and unacceptable.

The Displacement of State Courts and State Law

RICO was not intended "to federalize common law claims in commercial disputes." Campbell, *Civil RICO Actions In Commercial Litigation: Racketeer or Businessman?*, 36 SW. L.J. 925, 950 (1982). Yet, the decision below has opened the doors of the federal courts to garden-variety civil fraud claims, far divorced from the influences of organized crime, that have traditionally been litigated in state courts. W.H. Rehnquist, *Remarks of the Chief Justice on Diversity Jurisdiction and Civil RICO*, 21 ST. MARY'S L.J. 5, 10-11 (1989); *H.J. Inc. v. Northwestern Bell Tel. Co.*, 492 U.S. 229, 255 (Scalia, J., concurring) (citation omitted). By permitting plaintiffs to assert under RICO securities fraud claims that otherwise would be barred from the federal courts, the decision below displaces state law and state courts, without serving any genuine federal interest. This frontal assault upon federalism, and the federal courts, is neither compelled nor warranted by the words of RICO or sound public policy.

The Threat to the Rule of Law

A civil liability system which compels private parties to settle actions, without regard for the merits of the claim or culpability involved, undermines the rule of law. If we are a nation of laws, with private relationships so ordered, the application of law to conduct to determine liability would seem elemental and indispensable. However, in the context of RICO and securities litigation, cases are brought with the sole aim to extract a settlement, and claims are often settled regardless of the merits. Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 568-70 (1991). By eliminating one essential constraint upon strike suits, the Court below undermines the merit-based adjudication of grievances, and renders irrelevant the extensive body of securities law that operates as a shield in securities litigation.

CONCLUSION

For all of the foregoing reasons, the judgment of the Court of Appeals for the Ninth Circuit should be reversed, insofar as it reversed the order of the District Court.

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